

Assisting the Consumer Debtor, Part II: Defenses to Consumer Credit Claims

By Daniel Schlanger

This article is the second installment of a three-part series which aims to provide the general practitioner with a basic orientation on representing consumers in collection actions. Part I focused on identifying potential counterclaims and third-party claims, particularly those arising out of state and federal consumer protection statutes, such as the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692 *et seq.*, the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, and New York General Business Law § 349.



In this installment, I focus on potential defenses to consumer collection actions. I note in this regard that the New York judiciary is, in this author's experience, at something of a crossroads, with many jurists deeply concerned about the routinely sloppy and deficient pleadings churned out by the hundreds of thousands by a handful of collection firms (*Justice Disserved*, MFY Legal Services, Consumer Rights Projects), June 2008, available at http://www.mfy.org/Justice_Disserved.pdf),¹ as well as the typical scarcity of admissible evidence of indebtedness. See, e.g., *MBNA Am. Bank v. Nelson*, 2007 WL 1704618, at *2 (Civ. Ct., Richmond Co.). Indeed, some judges have begun to review these pleadings more strictly even on motions for default. (The most notable of these, no doubt, is Judge Arthur M. Schack of Kings County Supreme Court, who has issued a string of widely reported, and increasingly scathing, decisions denying default judgments in foreclosure actions). Other jurists, however, are more skeptical, and may be motivated by a view, articulated or not, that the consumer is "just trying to get out of it on a technicality."

What follows is not by any means meant to be an exhaustive list of possible defenses. Rather, I merely hope to flag a few key, potentially fruitful issues. One common thread throughout many of these defenses is that their potential stems from the predominant business model for collection of distressed accounts in the United States. Typically, an account that is classified as seriously delinquent is not held by the original creditor, but rather is bundled and sold (and re-bundled and re-sold) on the secondary market. Because these accounts are handled in bulk, are purchased for pennies on the dollar, and are often litigated by assignees focused on

taking defaults without proving up claims, it is common for the plaintiff in a collection action to have only a bare minimum of information and even less documentary support at the time the suit is brought. In many instances, the plaintiff cannot access additional information and documentation when challenged. This business model also "sweeps up" large numbers of accounts with significant, substantive problems relating to the underlying account, such as prior payment, or identity theft.

1. Which Statute of Limitations Applies and Has It Run?

The typical consumer collection action is for breach of contract and/or account stated. Pursuant to CPLR 213, these causes of action both have a statute of limitations of six years. As obvious as it sounds, it is critical that the practitioner check with the client regarding the last date on which he or she made a purchase or payment. The practitioner will find that in a significant minority of cases, the claim is time-barred under New York's six-year statute of limitations. The practitioner should note in this regard that statements about "date of last activity," etc. made by the debt buyer or on credit reports are not always trustworthy. In particular, these dates often reflect merely the date the account was purchased by the most recent assignee, not the date that the client made a purchase or payment.

Moreover, practitioners should inquire into the circumstances of the last payment with an eye toward New York's limitations on construing partial payment as a toll on the statute of limitations. Specifically, "[a]s to part payment, the statute will be tolled if the creditor demonstrates that it was payment of a portion of an admitted debt, made and accepted as such, accompanied by circumstances amounting to an absolute and unqualified acknowledgment by the debtor of more being due, from which a promise may be inferred to pay the remainder," *Erdheim v. Gelfman*, 303 A.D.2d 714 (2d Dep't 2003) (citations omitted) (emphasis added).

If the debt is less than six years old, the next question is whether it is subject to CPLR 202, which provides that where a cause of action accrues outside of New York, a non-resident Plaintiff is bound by the shorter of New York's limitations period and limitations period in the state where the action accrued. Accrual is determined by the "place of injury" and, where the damage alleged is economic loss, "the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss." *Global Financial*

Corp. v. Triarc Corp., 93 N.Y.2d 525 (1999). Finally, “the place of residence for the purpose of CPLR 202 is traditionally the state of incorporation or the corporation’s principal place of business.” *Beana v. Woori Bank*, 2006 WL 2935752 at *6 (S.D.N.Y. 2006).²

Taken in combination with one another, these rules regarding application of CPLR 202 provide strong support for shortening the statute of limitations where, as will often be the case, the consumer collection plaintiff is incorporated and/or headquartered in states, such as Delaware, that have a three-year statute of limitations.³

Finally, the practitioner should keep in mind that pursuant to the UCC § 2-725, the statute of limitations for a sale of goods is four years, not six. Although this provision will not apply in the typical credit card cases, it may apply in a variety of other circumstances involving the direct sale of goods by a merchant who extends credit. Although the author is unaware of any New York authority directly on point, several courts around the country have applied the UCC’s four-year statute of limitations to store cards. *Gimbel Bros., Inc. v. Cohen*, 46 Pa. D. & C.2d 747 (Ct. Com. Pl., Montgomery Co. 1969); *May Co. v. Trusnik*, 54 Ohio App.2d 71, 375 N.E.2d 72 (1977). See also *Globekirk Ltd. v. E.D. & F. Man Coffee, Ltd.*, 123 Misc. 2d 902 (New York County 1984). The courts have yet to fully grapple with the issue of how to apply this rule where the “store card” is set up through a related corporate entity rather than through the retail store that offers the card and provides the goods.⁴

2. Standing

As the Court of Appeals has famously noted, “If standing is denied, the pathway to the courthouse is blocked. The plaintiff who has standing, however, may cross the threshold and seek judicial redress.” *Saratoga County Chamber of Commerce, Inc. v. Pataki*, 100 N.Y.2d 801 (2003).

The practitioner should never assume that a Plaintiff other than the original creditor can prove its standing to bring suit. Many Plaintiffs are simply unable to produce any documentation evidencing a chain of title from the original creditor to themselves. See, e.g., *Gemini Asset Recoveries, Inc./Cohen and Slamowitz, LLP v. Portoff*, 23 Misc.3d 139(A) (1st Dep’t 2009). Moreover, even where documentation is provided, it is very often sorely lacking. For example, of those Plaintiffs who are able to produce some documentation on this point, a large number will produce a generic assignment that refers to a list of accounts that is not attached, such that there is no evidence that the consumer’s account was actually one of those assigned. See *LVNV Funding, LLC v. Delgado*, 24 Misc.3d 1230(A) (Nassau County 2009).⁵ In some cases, debt buyers that lack documentation will, when pushed on this issue, opt to dismiss their claims.

Nor is this issue merely a technical one of “making them prove it.” Rather, because of the repeated, mass bundling and sale of consumer debts, failure to force a Plaintiff to prove its ownership of the debt leaves a consumer vulnerable to being sued on the same debt multiple times by different alleged “assignee.” For this reason, it is important in this author’s view to provide for some mechanism in any settlement (whether a hold harmless clause, a liquidated damages clause, etc.) that protects the consumer from future collection activity taken by another entity alleging an ownership interest in the debt.

3. Personal Jurisdiction

As underlined by the New York Attorney General’s recent suit against no fewer than thirty-eight collection law firms regarding systemic bad service of process, and the NYAG’s criminal indictment of the head of American Legal Process regarding the same issue, New York suffers from massive and widespread “sewer service” problems. See *Pfau v. Forster & Garbus, et al.*, Index No.: 2009-8236, Supreme Court, Erie Co., *Justice Disserved*, (MFY Legal Services, Consumer Rights Projects), June 2008, available at http://www.mfy.org/Justice_Disserved.pdf.

As a result, it is all too common that a potential client will not have been properly served and that the Affidavit of Service filed with the court is substantially false. Although this issue most frequently arises in the context of motions for vacatur/relief from judgment (the subject of the third and final installment of this series), it is also commonly arises in scenarios where the consumer gets actual notice via service made upon a relative or neighbor (or by mail only without affixation to his door). See *Saxon Mortg. Services, Inc. v. Bell*, 63 A.D.3d 1029 (2d Dep’t 2009) (“actual notice alone will not sustain the service or subject a person to the court’s jurisdiction when there has not been compliance with prescribed conditions of service”).

Proving service at an incorrect address is hardly an arcane art: The consumer’s attorney is looking to present as many convincing indices as possible of the consumer not having lived at the address where service was made (e.g., lease agreements or rent statements regarding the actual address of residence; utility bills; bank statements; etc.). Affidavits from others living at the actual or the served residence may also be useful, as are affidavits from property managers. Where service is alleged upon fictitious “persons of suitable age and discretion,” affidavits obviously are crucial.

Unlike most other defenses, simply raising the defense of lack of personal jurisdiction is not sufficient to preserve it throughout the proceeding. Rather, the Defendant who has raised this defense in its Answer must make a motion to dismiss on this basis within 60 days of filing the Answer pursuant to CPLR 3211(e).

(Of course, one may also file a motion to dismiss on this basis in lieu of filing an Answer).

With regard to personal jurisdiction, the practitioner should also be aware that pursuant to CPLR 306-b, an unsuccessful attempt at service does not result in an extension of the 120-day period between filing and service absent “good cause shown or in the interest of justice.” *Leader v. Maroney, Ponzini, & Spencer*, 97 N.Y.2d 96, 105 (2001). Plaintiffs who are determined by the court to have failed to serve a consumer thus have no assurance that they will be allowed to re-serve without also re-filing. The end result is that Plaintiff’s claims, even if timely originally, may well be time-barred by the time the issue of service is litigated and the case re-filed. *Hafkin v. North Shore University Hospital*, 279 A.D.2d 68 (2d Dep’t 2000). (Crucially, CPLR 205(a)’s tolling provisions explicitly exclude re-filing based upon failure to serve.) It is for this reason that the collection bar routinely asks litigants (including *pro se* litigants) to waive personal jurisdiction in return for any extension of time to answer or any other routine stipulation. For the reasons just described, where there are real issues with personal jurisdiction, such a waiver implicates not only the defense of personal jurisdiction but also the defense of statute of limitations, and cannot be lightly agreed to.

4. Evidentiary Issues

Perhaps because the business model of the collection industry is based on the premise that the vast majority of claims will result in default judgment, creditors are routinely unprepared to prove up the debt. Indeed, with regard to debt buyers (as opposed to original creditors), a Plaintiff will—unless facing a counterclaim—sometimes simply dismiss when pushed for proof.

With regard to credit card collections, the creditor must prove by admissible evidence: “(1) Existence of an agreement between the defendant and the credit card issuer, (2) Issuance of the credit card at the defendant’s address, (3) Use of the credit card, and (4) Retention of monthly statements and payments on the account. [Although] [e]ven without a signed application, the absence of the underlying agreement would not relieve a defendant from his obligation to pay for goods and services rendered on credit.” *Worldwide Asset Purchasing, LLC v. Akrofi*, 884 N.Y.S.2d 631 (N.Y. City Ct. 2009) summarizing *Citibank v. Roberts*, 304 A.D.2d 901 (3rd Dep’t 2003). If the credit card account has been assigned, the assignee must also produce competent proof of assignment. See, e.g., *Citibank (S.D.) N.A. v. Martin*, 11 Misc.3d 219, 807 N.Y.S.2d 284 (NYC Civ. Ct. 2005).

A collection action is, of course, subject to the same standards of admissibility as any other action. Of particular relevance is the standard applicable to the ubiquitous “record keeper” affiant found in most consumer

creditor pleadings. These affiants will often have great difficulty alleging “personal knowledge of the operative facts” in any meaningful sense. *David Graubert, Inc. v. Bank Leumi Trust Co.*, 48 N.Y.2d 554 (1st Dep’t 1979). Nor will their statements typically be “specific, with concrete particulars, and not merely conclusory.” *Bickerstaff v. Vassar Oil*, 196 F.3d 435, 452 (2d Cir. 1998). Moreover, the affiant will routinely allege personal knowledge based on documents without “annex[ing] the documentary evidence to the affidavit,” as required. *Watt v. Mark Irish*, 184 Misc.2d 413, 708 N.Y.S.2d 264 (Columbia 2000); *Salas v. Lake of Luzerne*, 265 A.D.2d 770 (3d Dep’t 1999).

Crucially, in debt buyer cases, “the mere filing of papers received from other entities, even if they are retained in the regular course of business, is insufficient to qualify the documents as business records” (and thus subject to a hearsay exception). *Rushmore Recoveries v. Skolnick*, 15 Misc.3d 1139(A) (Nassau Co. 2007) (citing a fairly exhaustive list of evidentiary failures common to collection pleadings), quoting *Standard Textile Co., Inc. v. National Equipment Rental, Ltd.*, 80 A.D.2d 2d 911 (2nd Dep’t 1981).

Although, as seen from the citations above, these sorts of evidentiary failings are most commonly found in cases involving assignees, original creditors are by no means immune. Indeed, these same sorts of evidentiary shortcomings have featured prominently in several recent decisions denying arbitration awards sought by the purported original creditor. For example, in *MBNA Am. Bank v. Nelson*, 2007 WL 1704618 (Civ. Ct., Richmond Co. 2007), after discussing why the proffered affidavit failed, the court stated that although it appreciated “the allure that a summary process such as arbitration provides to a large commercial entity that holds hundreds of thousands, if not millions, of contracts for revolving credit...judicial economy...should not outweigh the alleged defaulter’s right to due process.” See also *MBNA Am. Bank v. Straub*, 12 Misc.3d 963 (Civ. Ct., N.Y. Cty. 2006).⁶

5. Offsets and Holder-in-Due-Course Status

In reviewing potential affirmative claims in Part I of this series, the reader may have noted that the most powerful federal statutes (e.g., FDCPA, TILA, and FCRA) have markedly short statutes of limitations. Notably, however, there is no statute of limitations regarding these or any other claims where they “ar[ise] from the transactions, occurrences, or series of transactions or occurrences, upon which a claim asserted in the complaint depends” and are made as offsets (i.e., for “recoupment”). CPLR 203(d). Although offsets are, by definition, limited to no more than the amount sought by the Plaintiff, this doctrine can still, at times, be a critical tool in defending consumer claims, especially against abusive debt collectors against whom the statute of limitations has already run.

In addition, as reviewed in Part I, a debt-buyer Plaintiff will typically not be shielded from either the defenses or counterclaims as a holder in due course, *inter alia*, because such a holder must take “without notice that [the obligation] is overdue or has been dishonored....” UCC § 3-302. The practitioner must therefore interview the client regarding the entire history of the transaction, not only the client’s interactions with the entity currently alleging ownership of the debt.

6. Last but Not Least: Is It Really Your Client’s Debt?

In striving to determine whether or not more “exotic” defenses might apply, the practitioner should not forget to first carefully question the client as to whether he or she truly ever owed the debt. This involves asking the client to elaborate on the circumstances under which any obligation may have been incurred. Examples of substantive, non-liability may include: identity theft; unauthorized credit card use by a family member; unauthorized charges by a merchant; unauthorized charges by a credit card issuer; charges for items subsequently returned; charges for items never delivered, etc. While, as noted at the outset of this article, some jurists are skeptical of the more “procedural” defenses elaborated above, very few are immune to the defense of, “This is not my debt.”

Finally, a related point. Just because the principal is owed does not mean that the balance sought by a creditor is proper. The overcharging of fees and interest is all too common. The diligent practitioner should investigate whether the interest rates, charges and fees assessed to the debtor are authorized by any alleged contract between the parties, as well as by law. On this latter point, see, e.g., NY Personal Property Law § 302(7) (the Motor Vehicle Installment Sales Act) (capping attorney’s fees at no more than 15% of the amount due) and NYPL § 413(5) (the Retail Installment Sales Act) (capping attorney’s fees at 20% of the amount due, and excluding litigation costs from its list of permissible charges).

Conclusion

Plaintiffs in consumer collection actions are typically not expecting to face a significant and skilled defense. Indeed, as reviewed above, the industry’s basic business model is based on herding large numbers of cases through the default judgment process without opposition from counsel familiar with the substantive, procedural and evidentiary defenses reviewed above. Although there are many, many cases in which the size of the claim and/or the relative weakness of the consumer’s defenses will severely limit the consumer’s (and counsel’s) options, there are a large number of consumer collection claims that are feasibly and cost-effectively attacked by the solo or small firm practitio-

ner on a variety of grounds, including those reviewed above.

Endnotes

1. MFY Legal Services’s excellent report entitled examined lawsuits brought in New York City Court’s by the seven biggest debt collection law firms in 2007 and reported astonishing findings: These seven collection firms filed 180,177 cases last year in New York City courts, constituting almost one-third of all the civil cases filed (excluding landlord/tenant and small claims). Notably, consumers only appeared in 8.5% of these cases.
2. The question of how to apply CPLR 202 where a non-resident Plaintiff alleging economic injury is headquartered in foreign state and incorporated in another is not settled, although sound policy considerations mitigate in favor of applying the shorter of the two non-New York limitations periods implicated.
3. It is unadvisable, however, to rely principally upon the Delaware choice-of-law provision found in many consumer credit agreements, as there is significant recent authority for the principle that (unlike the majority of states) New York considers the statute of limitations to be a “procedural” issue not determined by contractual choice of law provisions. *Portfolio Recovery Assoc., LLC v. King*, 55 A.D. 3d 1074 (3d Dep’t 2008). The flipside, of course, is that this same line of cases holds that a creditor is not entitled to rely on a contractual choice-of-law provision to gain the benefit of another state’s longer statute of limitations. *Education Resources Institute, Inc. v. Piazza*, 17 A.D. 3d 513 (2d Dep’t 2005) (Plaintiff not entitled to use of Ohio’s 15-year statute of limitations despite contractual Ohio choice-of-law provision).
4. The practitioner should also be aware of the Federal Communications Act, which provides a much shorter, two-year statute of limitations for actions brought by carriers. 47 U.S.C. § 415(a).
5. The problems Plaintiffs face are even more severe as applied to cases involved the bundling and sale of mortgage-backed securities. A slew of New York cases have invalidated last ditch attempts by such Plaintiffs to meeting the requirements of standing via “back dated” assignments, assignments executed without proper corporate authorization or power of attorney pursuant to RPL § 254(9), etc. See *US Bank v. Merino*, 16 Misc. 3d 209 (Sup. Ct., Suffolk Co. 2007); *US Bank v. Bernard*, 18 Misc. 3d 1130(A) (Sup. Ct., Kings Co. 2008); *US Bank v. Kosak*, 16 Misc. 3d 1133(A) (Sup. Ct., Suffolk Co. 2007); see also *Deutsche Bank Nat’l Trust Co. v. Clouden*, 851 N.Y.S.2d 57, 2007 WL 2709996, *4; *Wells Fargo Bank, N.A. v. Farmer*, 2008 WL 2309006 (Sup. Ct., Kings Co. 2008).
6. The *Nelson* court emphasized that a petitioner “must tender the actual provisions agreed to, including any and all amendments, and not simply a photocopy of general terms to which the credit issuer may currently demand [of] debtors.” *Nelson* at *7. The court noted that the credit card agreement referenced by Petitioner lacked, not only a signature, but “any name, account number or other identifying statements which would connect the proffered agreement with the Respondent in this action.” *Id.* The court found “these deficiencies of proof [to be] fatal.” *Id.* at 8.

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